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UNITED STATES FIRE INSURANCE COMPANY

IN THE UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

(OAKLAND DIVISION)

LENSCRAFTERS, INC.; and EYEXAM OF CALIFORNIA, INC.;

Plaintiffs,

vs.

LIBERTY MUTUAL FIRE INSURANCE COMPANY; EXECUTIVE RISK SPECIALTY INSURANCE COMPANY; UNITED STATES FIRE INSURANCE COMPANY; MARKEL AMERICAN INSURANCE COMPANY; and WESTCHESTER FIRE INSURANCE COMPANY,

Defendants.

Case No. C-07-2853 SBA
The Honorable Saundra B. Armstrong

E-FILING

U.S. FIRE'S REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS LENSCRAFTERS' SECOND AND THIRD CAUSES OF ACTION

DATE: January 29, 2008
TIME: 1:00 p.m.
CTRM: 3

I. INTRODUCTION

In tacit acknowledgment that the actual allegations made in its Complaint fail to state the elements required to show a ripe cause of action for breach of the duty to settle, LensCrafters' opposition rests entirely, and improperly, on factual assertions stated in a declaration. In resolving a motion to dismiss, however, a court must look only to the facts alleged in the operative pleading. Extrinsic assertions of fact, such as those in LensCrafters' counsel's declaration, are irrelevant. Indeed, LensCrafters' using a declaration to provide facts to support causes of action only highlights the shortcomings of the Complaint as drafted and illustrates why the claims alleged are not ripe and should be dismissed.

At best, LensCrafters' First Amended Complaint alleges only the following facts:

(1) LensCrafters had primary insurance through defendant Liberty Mutual Fire Insurance Company ("Liberty") and Executive Risk Specialty Insurance Company ("ERSIC"), whose combined limits are ***at least*** $51 million;

(2) U.S. Fire is an excess insurer over that primary insurance;

(3) Liberty and ERSIC owe a duty to defend -- and are fully funding the defense of -- the underlying *Snow* action, the very action upon which claims against U.S. Fire are based;

(3) LensCrafters entered into a tentative settlement agreement with the plaintiffs in the underlying *Snow* action; and

(4) None of LensCrafters' insurers agreed to fund that settlement, including Liberty and ERSIC (the defending insurers with the right and duty to control settlement negotiations).

These allegations fail to establish a ripe claim for breach of the duty to settle and, therefore, lack a foundational element of a claim for bad faith.

First, an excess insurer only has a duty to settle if and when the primary insurance has been exhausted or the insured has received a reasonable settlement demand the amount of which is greater than the sum of all primary policy limits and thus invades the excess layer. Here, LensCrafters does not allege facts showing either that the primary insurance has been exhausted or

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that the *Snow* settlement is in excess of the amount of all available primary insurance. To the contrary, LensCrafters alleges an extremely large, currently available primary insurance layer and fails to allege that the settlement demand exceeds that primary layer.

Second, generally, where an insured is receiving a defense from its insurers, the insured is barred from bringing a claim for breach of the duty to settle unless and until either a judgment in excess of policy limits is entered against it ***or*** the insured has actually paid at least some portion of the settlement. Again, in this case, LensCrafters does not allege that a judgment has been issued or that it has paid any settlement. Instead, LensCrafters alleges that Liberty and ERSIC are defending it and that the *Snow* action is still pending.

Finally, even if U.S. Fire had a duty to settle under the facts alleged in the Complaint (it does not), LensCrafters shall failed to allege facts showing ***damages*** resulting from a breach of that duty. Instead, the Complaint includes only a conclusory assertion that LensCrafters has been damaged, which is insufficient to state a cause of action in these circumstances: Where an insured is being fully defended by insurers and it is not currently paying any of its own money in relation of the claim, as LensCrafters alleges here, it must do more than simply assert damages when the facts alleged do not demonstrate any damages. *See Bell Atlantic Corp. v. Twombly*, __ U.S. __, 127 S.Ct. 1955, 1964-65 (2007).

Recognizing that its complaint is deficient, LensCrafters attempts to add facts from beyond the four corners of its pleadings. Instead of seeking leave to amend to allege these additional facts, however, it simply asserts them, citing not to the Complaint but to an improper declaration that is irrelevant to this motion. If the Complaint adequately alleged causes of action for breach of the duty to settle and bad faith, no declaration or improper citation to extrinsic facts would be necessary to show the existence of a valid cause of action. In fact, the extrinsic facts on which LensCrafters relies in its opposition actually ***contradict*** the allegations of its Complaint. Thus, LensCrafters as much as concedes that its pleading fails to allege a ripe cause of action for breach of the duty to settle or bad faith.

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II. DISCUSSION

A. LensCrafters' Reliance On Extrinsic Facts Is Improper

LensCrafters' opposition purports to rely a section titled "Statement of Facts." (*See* Opp. at 2 -4.) This discussion of the "facts," however, is not limited to the facts alleged in LensCrafters' operative pleading. Instead, it is based almost entirely on the declaration of Celia M. Jackson, LensCrafters' counsel. (*Id*. at 2-4.) In the factual subsection titled "The Events Leading to Insurers' Breach of the Insurance Contracts," on which LensCrafters relies to argue against dismissal of its unripe claims, there is only a ***single*** citation to the Complaint. All of the other facts cited in the Opposition -- that LensCrafters communicated the proposed settlement to its insurers and has been negotiating with them, that LensCrafters' primary insurers agree that the proposed settlement is reasonable and have offered to contribute their "limits" of liability, that additional funds are needed from the excess insurers to pay for the settlement -- are supported ***only*** by the declaration and are not cited in any pleading. (*Id.* at 2:25-3:6.)

LensCrafters does not and cannot contest that the Court's review of this motion to dismiss should be limited to the contents of the Complaint. *See United State v. Ritchie*, 342 F.3d 903, 908-09 (9th Cir. 2003); *see also No. 84 Employer-Teamster Joint Counsel Pension Trust Fund v. Am. West Holding Corp.*, 320 F.3d 920, 925 n.2 (9th Cir. 2003). Nor does LensCrafters contest that it is inappropriate to assume a plaintiff "can prove facts which it has not alleged." *Associated Gen. Contractors of Calif., Inc. v. Calif. State Council of Carpenters*, 459 U.S. 519, 526 (1983). When determining whether to grant a motion to dismiss for failure to state a claim, therefore, the Court may not look to new facts asserted in the Opposition because such facts "are irrelevant for Rule 12(b)(6) purposes." *Schneider v. Calif. Dep't of Corrections*, 151 F.3d 1194, 1197 n.1 (9th Cir. 2003).

In order to avoid a motion to dismiss, LensCrafters must establish that the allegations already contained in its Complaint state a ripe claim for breach of contract and bad faith. LensCrafters clearly cannot do so. Accordingly, this motion to dismiss should be granted.

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B. LensCrafters' Allegations Do Not State A Ripe Cause Of Action For Breach Of Contract

LensCrafters appears to concede that its Complaint does not allege a breach of the duty to indemnify, arguing only that it is basing its breach of contract claim on a breach of U.S. Fire's alleged duty to settle. (Opp. at 5:22 ("The gravamen of LensCrafters' newly pleaded claims is Insurers' duty to settle").) LensCrafters contends that U.S. Fire breached an alleged duty to settle by refusing to accept a settlement demand in the *Snow* action. LesnCrafters' allegations, however, fail to set forth the existence of any such duty -- let alone its breach.

The parties agree that, as a general matter, where an insured is being defended by its primary insurer, that primary insurer has the right and duty to negotiate a reasonable settlement. *See PPG Indus. v. Transamerica Ins. Co.*, 30 Cal.4th 310, 321 (1999) ("[T]he insurer has a duty to make reasonable efforts to settle a claim against its insured by the insured's victim . . . . The insurer's duty to settle arises from its interrelated duty to defend"); *Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.*, 227 Cal. App.3d 563, 578 (1991).

In *Diamond Heights*, a case extensively relied upon by LensCrafters, the settlement demand undisputedly exceeded the defending primary insurers' policy limits and the primary insurers had already committed to pay the entirety of their undisputed policy limits to that settlement. *Id.* at 575. The insured requested that the excess insurer agree to pay the portion of the settlement that invaded the excess policy layer. *Id.* The excess carrier refused and argued that -- without its express consent -- it could not be bound by a settlement negotiated by the primary insurer that invaded the excess layer. *Id.* The court disagreed, holding that a primary insurer may negotiate a settlement that invades the excess layer and that is binding upon an excess insurer if the settlement offer is reasonable and undisputedly exhausts the primary carrier's limits. *Id.* Thus, the court's discussion of the excess insurer's duty to settle was predicated entirely upon a settlement demand had that undisputedly invaded the excess layer. *Id.* But this is not the situation LensCrafters alleges in the Complaint.

Here, LensCrafters alleges only that a tentative settlement agreement has been reached and that its insurers, including its primary insurers, have not accepted or funded the settlement.

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(FAC at ¶ 44.) LensCrafters alleges no facts -- not one -- to indicate that the proposed settlement amount exceeds its alleged $51 million primary layer. Absent such an allegation, that there is no basis on which to conclude that U.S. Fire's excess policy has been even potentially triggered. U.S. Fire cannot have breached a duty to settle that has not even allegedly yet arisen.

Throughout its Opposition, LensCrafters concedes that an excess insurer cannot owe a duty to settle unless the settlement demand necessarily implicates the excess layer. (*See, e.g.*, Opp. at 6:17-21 (arguing that an excess insurer has a duty to settle "where a settlement cannot be achieved without the contribution of an excess insurer, and the excess insurer has been made aware of that fact, and therefore can control the settlement").) For example, LensCrafters cites to *Fuller-Austin Insulation Co. v. Highlands Ins. Co.* for the proposition that "an excess insurer, although not contractually obligated to take an active part in the defense of an insured, still owes its insured a duty of good faith ***when faced with an offer of settlement that exhausts the underlying policy limits***." 135 Cal.App.4th 958, 986 (2006) (emphasis added). But LensCrafters alleges no facts to meet the standard it admits applies.

To remedy this flaw, LensCrafters now asserts that Liberty and ERSIC "have offered to contribute their limits of liability" and that "additional funds are needed from the excess insurers . . . to pay for the settlement." (Opp. at 2:28-3:3.) However, these new extrinsic factual assertions are entirely irrelevant to the Court's determination of this motion and, thus, cannot be considered. Further, these factual allegations directly contradict LensCrafters allegation in the Complaint that none of the insurers, including Liberty and ERSIC, agreed to accept and fund the settlement. (FAC at ¶ 44.) Assuming, *arguendo*, that these new factual assertions properly and accurately reflect developments ***after*** the filing of the Complaint, this only further illustrates that the Complaint alleges an unripe claim for breach of contract.

C. LesCrafters Has Not Sufficiently Alleged "Damages" Resulting From Any Alleged Breach

LensCrafters argues that a single conclusory statement in the Complaint -- that "[a]s a direct and proximate result of defendants' acts," it has "been damaged in an amount that is to be proved at trial" -- satisfies the requirement of alleging damages. (Opp. at 7:18-21.) It does not.

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Instead LensCrafters must satisfy the burden of alleging damages by setting forth ***facts*** and it cannot do so by merely including "a formulaic recitation of the elements of a cause of action. . . ." *See Bell Atlantic*, 127 S.Ct. at 1964-65. Contrary to LensCrafters' footnote "argument" that *Bell Atlantic*'s requirements are limited to the conspiracy element of an antitrust cause of action, *Bell Atlantic* actually addresses the fundamental burden a party must generally satisfy under the Federal Rules of Civil Procedure in order to allege the elements of ***any*** cause of action when challenged on a motion to dismiss. *See id.* at 1965 n.3 (noting that Rule 8(a)(2) "requires a 'showing,' rather than a blanket assertion, of entitlement to relief"). Similarly, in *Native American Arts, Inc. v. Specialty Merchandise Corporation*, the court granted the defendant's motion to dismiss, holding that the plaintiff's conclusory assertions referring to "competitive injury," "advertising injury" and "other damages" was insufficient "to establish the injury-in-fact requirement of standing." 451 F.Supp.2d 1080, 1082 (E.D. Cal. 2006). The district court dismissed the action even though the plaintiff asserted additional facts describing its alleged damages in its opposition papers, which might have been sufficient to satisfy the injury-in-fact requirement had they been properly alleged in the complaint. *Id.*

Here, LensCrafters, like the plaintiff in *Specialty Merchandize*, fails to allege ***facts*** showing that it has been damaged as a result of U.S. Fire's alleged breach of a duty to settle. LensCrafters appears to concede that, generally, judgment in excess of policy limits is a predicate fact necessary to show liability for and damages as a result of an alleged breach of the duty to settle. *J.B. Aguerre, Inc. v. Am. Guarantee & Liab. Ins. Co.*, 59 Cal.App.4th 6, 13 (1997). While LensCrafters also argues that damages arising out of a refusal to settle are not ***limited*** to the amount of an excess judgment, (Opp. at 10:14-11:1), this argument fails to address the issue of whether LensCrafters has adequately alleged any damages in the first place, whether limited to the amount of the judgment or not. LensCrafters also cites to cases where an insured claimed damages for emotional distress or loss of goodwill caused by insurers unreasonably delaying or refusing to settle.[1] *See, e.g., Bodenhamer v. Superior Court*, 192 Cal.App.3d 1472, 1479 (1987)

[1] Of course, LensCrafters, an artificial legal entity, cannot argue that it could experience mental suffering or emotional distress. *See Diamond View Ltd. v. Herz,* 180 Cal.App.3d 612, 618 (1986).

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(claiming loss of goodwill caused by insurer's delay in settling claims). This authority only further illustrates the problem with LensCrafters' failure to allege any facts supporting its conclusory assertion of damage: Nowhere does LensCrafters allege any delay or that any delay -- even if it had both alleged -- in the settlement of the *Snow* action has caused it to suffer ***any*** damages other than the risk of a potential excess judgment. The risk of excess judgment does not constitute actionable damages. *See Emerald Bay Community Ass'n v. Golden Eagle Ins. Corp.*, 130 Cal.App.4th 1078, 1096 (2005) ("[P]laintiff needed to establish actual financial loss, not merely a potential that it may suffer a loss sometime in the future").

Again, LensCrafters seeks to remedy its insufficiently-pled causes of action by asserting new facts in its Opposition. The declaration asserts that the breach of the duty to settle has caused it to suffer monetary losses because of an independent agreement with its primary insurers to pay a portion of the *Snow* action defense fees. As discussed above, however, these newly-asserted "facts" are irrelevant to this Court's determination of whether damages have been properly alleged. This is especially true here, where the newly-asserted facts are inconsistent with (1) the allegations that Liberty and ERSIC are providing a defense to the *Snow* action as previously ordered by this Court and (2) the requirement that defending primary insurers provide full, complete defenses to their insureds. (*See* FAC at ¶ 31); *Buss v. Superior Court*, 16 Cal.4th 35, 49 (1997) ("To defend meaningfully, the insurer must defend immediately…to defend immediately, it must defend entirely"); *Haskel, Inc. v. Superior Court*, 33 Cal.App.4th 963, 976 (1995) (holding that if a primary insurer "owes any defense burden, it must be fully borne"). If LensCrafters is contending that it is not being properly defended by its primary insurers, these asserted "damages" are either the result of a breach of the duty to defend by Liberty and ERSIC or a voluntary agreement by LensCrafters. In either event, any such damages cannot be the result of any alleged conduct by U.S. Fire and could not constitute "damages" resulting from an alleged breach of the duty to settle by U.S. Fire (even if any damages allegations had been included in LensCrafters' Complaint, which they were not).

In sum, LensCrafters' conclusory allegation that it has suffered damages as a result of the alleged breach of the duty to settle is insufficient to state a cause of action. Although its

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declaration cannot be considered on this motion, even that fails to articulate any additional facts to show that damages resulted from any alleged delay in the settlement. While LensCrafters ***might*** be able to allege damages as a result of an excess judgment if and when such a judgment is entered, such speculative damages -- contingent on future events -- are insufficient to show that a ripe claim for breach of contract currently exists.

D. LensCrafters Cannot Maintain A Claim For Bad Faith Where It Has Failed To Adequately Allege A Cause Of Action For Breach Of Contract

LensCrafters does not contest that a ripe claim for breach of contract is a necessary element to assert a claim for bad faith. *Emerald Bay Community Ass'n*, 130 Cal.App.4th at 1096 (affirming dismissal of bad faith claim where the underlying breach of contract cause of action failed to state a claim). Because LensCrafters has not alleged a ripe claim for breach of contract, LensCrafters' claim for bad faith is necessarily unripe too.

III. CONCLUSION

LensCrafters' complaint does not allege facts sufficient to state a claim against U.S. Fire -- an excess carrier -- for breach of the duty to settle. Nor does it allege facts that demonstrate that any such alleged breach caused damages. While it tries to fix these deficiencies by submitting a declaration with its Opposition to this motion to dismiss, the newly-asserted facts in the declaration are irrelevant to the Court's determination and cannot be considered. This is especially true where, as here, the newly-asserted facts contradict both established law and those facts actually pled in LensCrafters' Complaint. LensCrafters' failure to adequately state a ripe claim for breach of contract necessarily bars it from asserting a claim for bad faith. Thus, U.S. Fire respectfully requests that the Court dismiss both LensCrafters' second cause of action for breach of contract and its third cause of action for bad faith.

Dated: January 15, 2008

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By: _____
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PROOF OF SERVICE

I am employed in the County of San Francisco, State of California. I am over the age of 18 and not a party to the within action; my business address is One Maritime Plaza, Third Floor, San Francisco, California 94111-3492.

On January 15, 2008, I served the following document described as:

U.S. FIRE INSURANCE COMPANY'S REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS LENSCRAFTERS' SECOND AND THIRD CAUSES OF ACTION

☒ VIA THE UNITED STATES DISTRICT COURT ELECTRONIC FILING SERVICE on interested parties in this action as set forth below:

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Executed on January 15, 2008, at San Francisco, California. I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Amy E. Rose